



Financial Management Report as of JUNE 30, 2008

AT A GLANCE:

General Fund revenues are behind last year by 0.4 percent. Sales tax revenue performance continues negative trend for second quarter 2008 (see page 5)

Development revenue down (see page 3)

Next, an Oscar? See sidebar story on page 2

Eastside home sales fall 38 percent; prices are flat (see page 8)

Inside this issue:

| | |
|-----------------------------|----|
| Expenditure Summary | 2 |
| General Fund Revenue | 3 |
| General Fund Expenditures | 4 |
| Sales Tax Revenue Analysis | 5 |
| Economic Environment Update | 7 |
| Investment Report | 8 |
| Reserve Summary | 10 |

Summary of All Operating Funds: *Revenue*

- **General Fund** actual 2008 revenue is **0.4 percent behind** the same period last year largely due to disappointing sales tax revenue and a significant decline in building permit and planning fee revenue. A more detailed analysis of General Fund revenue can be found on page 3, and sales tax revenue performance can be found beginning on page 5.
- **Other General Government Funds** actual 2008 revenue is **flat** compared to the same period last year due to a 29 percent decline in motor vehicle fuel tax revenue and variability in timing of cable tax revenue. The flat revenue is despite higher internal service rates, higher recreation fee revenue (earlier registrations for summer classes (which may be offset by lower revenues later in the year) and a new fitness pass program), higher hotel tax revenue, and a significant insurance recovery for park property damage. Motor vehicle fuel tax is collected as a flat rate per gallon and distributed by the State based on population. Increased fuel costs that decrease consumption (fewer gallons sold) have a negative impact on this revenue.
- **Water Sewer Operating Fund** actual 2008 revenue is **9.9 percent higher** than last year due primarily to water and sewer revenue, an increase in connection charge fee revenue, and a refund for prior year excise tax payments. Revenue was budgeted to increase 8 percent over 2007 due to higher rates.
- **Surface Water Management Fund** Surface Water fees are paid through property tax collection, which are primarily received in April and October. Actual 2008 revenue is **2.2 percent ahead** of the same period last year, which is within a normal range of variability.
- **Solid Waste Fund** revenue collection was budgeted to increase in 2008 over 2007 due to higher rates and normal growth. Actual 2008 revenue is **9.2 percent ahead** of the same period last year, which is higher than planned due to normal variability in billing collections.

| Resources by Fund | Year-to-Date Actual | | | Budget | | | % of Budget | |
|--------------------------------------|---------------------|-------------------|--------------|--------------------|--------------------|--------------|--------------|--------------|
| | 6/30/2007 | 6/30/2008 | % Change | 2007 | 2008 | % Change | 2007 | 2008 |
| General Gov't Operating: | | | | | | | | |
| General Fund | 25,189,702 | 24,863,276 | -1.3% | 54,543,825 | 53,226,984 | -2.4% | 46.2% | 46.7% |
| Other General Gov't Operating Funds | 8,584,941 | 8,588,177 | 0.0% | 16,736,577 | 17,027,124 | 1.7% | 51.3% | 50.4% |
| Total General Gov't Operating | 33,774,643 | 33,451,453 | -1.0% | 71,280,402 | 70,254,108 | -1.4% | 47.4% | 47.6% |
| Utilities: | | | | | | | | |
| Water/Sewer Operating Fund | 7,451,896 | 8,186,982 | 9.9% | 16,494,804 | 17,821,208 | 8.0% | 45.2% | 45.9% |
| Surface Water Management Fund | 2,749,851 | 2,811,350 | 2.2% | 5,233,189 | 5,274,145 | 0.8% | 52.5% | 53.3% |
| Solid Waste Fund | 3,876,838 | 4,235,031 | 9.2% | 7,909,347 | 8,365,262 | 5.8% | 49.0% | 50.6% |
| Total Utilities | 14,078,585 | 15,233,363 | 8.2% | 29,637,340 | 31,460,615 | 6.2% | 47.5% | 48.4% |
| Total All Operating Funds | 47,853,228 | 48,684,816 | 1.7% | 100,917,742 | 101,714,723 | 0.8% | 47.4% | 47.9% |

* Budgeted and actual revenues exclude resources forward and include interfund transfers.



The awards keep coming.....

After receiving an International Safety Media Award earlier this year for a pedestrian safety video produced by the Youth Council (see March FMR), the City of Kirkland's Multimedia Services and the Kirkland Senior Council were recently recognized by "The Telly Awards" for a video produced about senior neglect and abuse. "Elder Abuse, Neglect and Self-Neglect," a 20-minute informative video, received a Silver Telly in the category of health and fitness and a Bronze Telly in the category of information. The Telly Awards was founded in 1978 and is the premier award honoring outstanding local, regional, and cable TV commercials and programs. "Elder Abuse" can be viewed on KLIFE Comcast Channel 75. The program is also available on the City's website at www.ci.kirkland.wa.us/depart/TV/Video_On_Demand.htm.

Summary of All Operating Funds: *Expenditures*

- **General Fund** expenditures were budgeted to increase in 2008 over 2007 largely due to increased personnel costs. Actual expenditures are **9.9 percent ahead** of the same period last year primarily due to higher employee salary and benefit costs (including the settlement of labor contracts with back payments for 2007).
- **Other Operating Funds** expenditures were budgeted to decrease in 2008 over 2007 primarily due to the timing of vehicle purchases and one-time costs budgeted in 2007, and despite higher personnel costs. Actual expenditures are **4.3 percent ahead** of the same period last year primarily due to higher personnel and fuel costs, as well as timing of vehicle and computer purchases.
- **Water/Sewer Operating Fund** 2008 expenditures were budgeted to increase slightly over 2007 primarily due to one-time costs budgeted in 2007 and despite expected higher personnel, water purchase, and sewer processing costs in 2008. Actual 2008 expenditures are **4.5 percent ahead** of the same period last year primarily due to higher personnel, water purchase, and METRO sewer costs and despite a significant decline in regional water connection charges.
- **Surface Water Management Fund** expenditures were budgeted to decrease in 2008 over 2007 primarily due to the timing of one-time projects and despite higher personnel costs. Actual 2008 expenditures are **8.5 percent ahead** of the same period last year due to higher personnel costs and the significant progress made in 2008 on plans that were budgeted in 2007.
- **Solid Waste Fund** expenditures were budgeted to increase in 2008 over 2007 due primarily to higher solid waste contract rates. Actual 2008 expenditures are **6.5 percent behind** the same period last year due to the timing of disposal contract billing payments.

| Expenditures by Fund | Year-to-Date Actual | | | Budget | | | % of Budget | |
|--------------------------------------|---------------------|-------------------|-------------|--------------------|--------------------|-------------|--------------|--------------|
| | 6/30/2007 | 6/30/2008 | % Change | 2007 | 2008 | % Change | 2007 | 2008 |
| General Gov't Operating: | | | | | | | | |
| General Fund | 25,125,383 | 27,606,316 | 9.9% | 54,678,073 | 56,618,825 | 3.5% | 46.0% | 48.8% |
| Other General Gov't Operating Funds | 7,672,374 | 8,004,441 | 4.3% | 17,365,027 | 16,797,729 | -3.3% | 44.2% | 47.7% |
| Total General Gov't Operating | 32,797,757 | 35,610,757 | 8.6% | 72,043,100 | 73,416,554 | 1.9% | 45.5% | 48.5% |
| Utilities: | | | | | | | | |
| Water/Sewer Operating Fund | 8,786,636 | 9,181,757 | 4.5% | 16,920,331 | 16,951,605 | 0.2% | 51.9% | 54.2% |
| Surface Water Management Fund | 2,522,437 | 2,737,445 | 8.5% | 5,646,269 | 5,635,234 | -0.2% | 44.7% | 48.6% |
| Solid Waste Fund | 3,832,537 | 3,583,106 | -6.5% | 7,860,424 | 8,221,762 | 4.6% | 48.8% | 43.6% |
| Total Utilities | 15,141,610 | 15,502,308 | 2.4% | 30,427,024 | 30,808,601 | 1.3% | 49.8% | 50.3% |
| Total All Operating Funds | 47,939,367 | 51,113,065 | 6.6% | 102,470,124 | 104,225,155 | 1.7% | 46.8% | 49.0% |

* Budgeted and actual expenditures exclude working capital, operating reserves, capital reserves, and include interfund transfers.

General Fund Revenue

Many significant General Fund revenue sources are economically sensitive, such as sales tax and development-related fees.

- **Sales tax** revenue for 2008 was originally planned to increase slightly over 2007. The budget was adjusted downward in March because of disappointing performance early in the year. However, actual 2008 revenue is continuing an even steeper decline, **down 12.6 percent** compared to the same period last year. A one-time adjustment in 2007 skews the comparison; however this revenue is still down about 9.8 percent after factoring out the one-time event. A detailed analysis of sales tax revenue can be found starting on page 5.
- **Utility tax** actual revenue collection is **8.7 percent** ahead of the same period last year primarily due to growth in electricity and telephone tax revenue.
- **Other taxes** actual revenue is **19.6 percent** ahead of the same period last year primarily due to the one-time receipt of E-911 tax revenue for reimbursement of dispatch equipment and overtime.
- **Business licenses and franchise fees** actual revenue is **8.1 percent** ahead of the same period last year due to franchise fee revenue. The revenue generating regulatory license fee is **10.4 percent** ahead of the same period last year, in part due to collection of delinquent accounts. Variability of the timing of renewals from

larger businesses can skew year-to-year comparisons.

- **Other licenses and permits** are **77.5 percent** ahead of the same period last year due to one-time revenue received for the Verizon fiber project inspections and alarm registrations.
- **Development-related fee** revenues remain a mixed bag. Collectively, actual 2008 revenue is **down 10.4 percent** compared to the same period last year. **Building/structural permits** actual 2008 revenue is **14.7 percent** lower than the same period in 2007. **Plan check fees** actual revenue is **6.8 percent** ahead compared to the same period in 2007. **Planning fees** are **down 39 percent** compared to the same period last year, while **engineering services** revenue is **up 19.3 percent** over the same period last year. The trends for development-related revenue in 2008 reflect the volatility that is inherent in development activity and also are reflected in sales tax revenue performance (see page 5).
- *Note: Fire District #41 and EMS revenue is normally received in the second half of the year.*

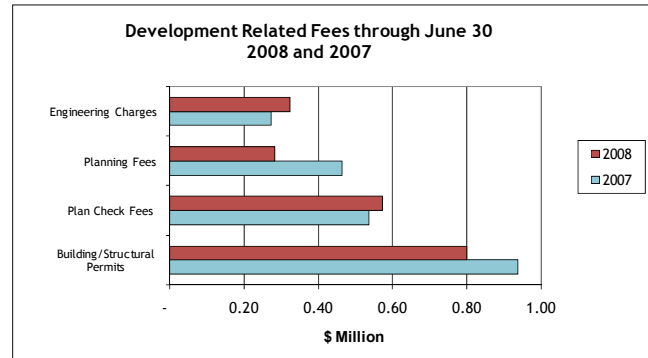
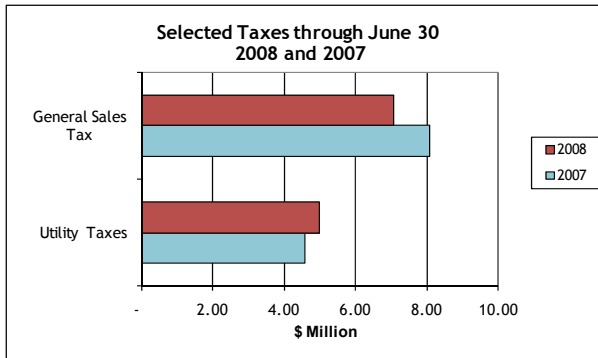
General Fund 2008 revenues are \$0.36 million lower than the same period in 2007 largely due to slumping sales tax and development-related revenue and despite strong utility taxes.

The General Fund is the largest of the General Government Operating funds. It is primarily tax supported and accounts for basic services such as public safety, parks and recreation, and community development.

About 374 of the City's 470 permanent employees are budgeted within this fund.

| General Fund Resource Category | Year-to-Date Actual | | | Budget | | | % of Budget | |
|--|---------------------|-------------------|--------------|-------------------|-------------------|---------------|--------------|--------------|
| | 6/30/2007 | 6/30/2008 | % Change | 2007 | 2008 | % Change | 2007 | 2008 |
| Taxes: | | | | | | | | |
| Retail Sales Tax: General | 8,086,395 | 7,068,768 | -12.6% | 15,918,981 | 15,756,800 | -1.0% | 50.8% | 44.9% |
| Retail Sales Tax: Criminal Justice | 550,831 | 569,086 | 3.3% | 1,114,253 | 1,050,000 | -5.8% | 49.4% | 54.2% |
| Property Tax | 4,531,858 | 4,825,375 | 6.5% | 8,790,086 | 9,037,710 | 2.8% | 51.6% | 53.4% |
| Utility Taxes | 4,588,082 | 4,985,699 | 8.7% | 8,723,683 | 8,145,822 | -6.6% | 52.6% | 61.2% |
| Rev Generating Regulatory License | 512,755 | 566,150 | 10.4% | 936,671 | 990,000 | 5.7% | 54.7% | 57.2% |
| Other Taxes | 204,663 | 244,678 | 19.6% | 462,597 | 334,654 | -27.7% | 44.2% | 73.1% |
| Total Taxes | 18,474,584 | 18,259,756 | -1.2% | 35,946,271 | 35,314,986 | -1.8% | 51.4% | 51.7% |
| Licenses & Permits: | | | | | | | | |
| Building, Structural & Equipment Permits | 937,418 | 800,081 | -14.7% | 2,078,436 | 2,163,450 | 4.1% | 45.1% | 37.0% |
| Business Licenses/Franchise Fees | 732,932 | 792,595 | 8.1% | 1,421,435 | 1,449,450 | 2.0% | 51.6% | 54.7% |
| Other Licenses & Permits | 88,741 | 157,528 | 77.5% | 188,749 | 193,900 | 2.7% | 47.0% | 81.2% |
| Total Licenses & Permits | 1,759,091 | 1,750,204 | -0.5% | 3,688,620 | 3,806,800 | 3.2% | 47.7% | 46.0% |
| Intergovernmental: | | | | | | | | |
| Grants | 98,795 | 102,002 | 3.2% | 182,160 | 36,784 | -79.8% | 54.2% | 277.3% |
| State Shared Revenues & Entitlements | 331,428 | 318,224 | -4.0% | 623,230 | 645,318 | 3.5% | 53.2% | 49.3% |
| Fire District #41 | - | - | N/A | 3,184,310 | 3,487,428 | N/A | N/A | N/A |
| EMS | - | - | N/A | 504,376 | 793,023 | N/A | N/A | N/A |
| Other Intergovernmental Services | 296,068 | 311,030 | 5.1% | 589,478 | 439,609 | -25.4% | 50.2% | 70.8% |
| Total Intergovernmental | 726,291 | 731,256 | 0.7% | 5,083,554 | 5,402,162 | 6.3% | 14.3% | 13.5% |
| Charges for Services: | | | | | | | | |
| Internal Charges | 1,710,072 | 1,764,207 | 3.2% | 3,443,777 | 3,511,012 | 2.0% | 49.7% | 50.2% |
| Engineering Services | 271,776 | 324,212 | 19.3% | 635,000 | 610,000 | -3.9% | 42.8% | 53.1% |
| Plan Check Fee | 536,445 | 572,904 | 6.8% | 958,700 | 900,000 | -6.1% | 56.0% | 63.7% |
| Planning Fees | 463,770 | 282,676 | -39.0% | 968,900 | 1,194,637 | 23.3% | 47.9% | 23.7% |
| Recreation | 38,824 | 40,511 | 4.3% | 79,516 | 83,000 | 4.4% | 48.8% | 48.8% |
| Other Charges for Services | 459,898 | 313,056 | -31.9% | 880,191 | 677,323 | -23.0% | 52.2% | 46.2% |
| Total Charges for Services | 3,480,785 | 3,297,566 | -5.3% | 6,966,084 | 6,975,972 | 0.1% | 50.0% | 47.3% |
| Fines & Forfeits | 557,145 | 589,744 | 5.9% | 1,317,860 | 1,132,000 | -14.1% | 42.3% | 52.1% |
| Miscellaneous | 191,806 | 205,912 | 7.4% | 553,002 | 404,150 | -26.9% | 34.7% | 50.9% |
| Total Revenues | 25,189,702 | 24,834,438 | -1.4% | 53,555,391 | 53,036,070 | -1.0% | 47.0% | 46.8% |
| Other Financing Sources: | | | | | | | | |
| Interfund Transfers | - | 28,838 | N/A | 988,434 | 190,914 | N/A | N/A | 15.1% |
| Total Other Financing Sources | - | 28,838 | N/A | 988,434 | 190,914 | N/A | N/A | 15.1% |
| Total Resources | 25,189,702 | 24,863,276 | -1.3% | 54,543,825 | 53,226,984 | -2.4% | 46.2% | 46.7% |

* Budgeted and actual revenues exclude resources forward.

General Fund Revenue *continued*

General Fund Expenditures

| General Fund Department Expenditures | Year-to-Date Actual | | | Budget | | | % of Budget | |
|--|---------------------|-------------------|--------------|-------------------|-------------------|--------------|--------------|--------------|
| | 6/30/2007 | 6/30/2008 | % Change | 2007 | 2008 | % Change | 2007 | 2008 |
| Non-Departmental | 472,296 | 501,809 | 6.2% | 1,126,152 | 1,141,474 | 1.4% | 41.9% | 44.0% |
| City Council | 182,545 | 229,800 | 25.9% | 316,392 | 359,934 | 13.8% | 57.7% | 63.8% |
| City Manager's Office | 1,421,741 | 1,829,955 | 28.7% | 3,419,542 | 3,739,425 | 9.4% | 41.6% | 48.9% |
| Human Resources | 490,228 | 514,409 | 4.9% | 1,039,649 | 1,122,706 | 8.0% | 47.2% | 45.8% |
| City Attorney's Office | 433,438 | 463,776 | 7.0% | 957,460 | 991,985 | 3.6% | 45.3% | 46.8% |
| Parks & Community Services | 2,471,573 | 2,656,723 | 7.5% | 5,889,784 | 6,048,645 | 2.7% | 42.0% | 43.9% |
| Public Works (Engineering) | 1,759,699 | 1,700,269 | -3.4% | 3,643,248 | 3,578,878 | -1.8% | 48.3% | 47.5% |
| Finance and Administration | 1,670,064 | 1,708,415 | 2.3% | 3,420,487 | 3,536,915 | 3.4% | 48.8% | 48.3% |
| Planning & Community Development | 1,588,264 | 1,735,650 | 9.3% | 4,105,866 | 3,381,197 | -17.6% | 38.7% | 51.3% |
| Police | 6,442,467 | 7,660,269 | 18.9% | 14,236,955 | 14,689,726 | 3.2% | 45.3% | 52.1% |
| Fire & Building | 7,942,915 | 8,362,178 | 5.3% | 15,817,178 | 16,846,282 | 6.5% | 50.2% | 49.6% |
| Total Expenditures | 24,875,230 | 27,363,253 | 10.0% | 53,972,713 | 55,437,167 | 2.7% | 46.1% | 49.4% |
| Other Financing Uses: | | | | | | | | |
| Interfund Transfers | 250,153 | 243,063 | -2.8% | 705,360 | 1,181,658 | 67.5% | 35.5% | 20.6% |
| Total Other Financing Uses | 250,153 | 243,063 | -2.8% | 705,360 | 1,181,658 | 67.5% | 35.5% | 20.6% |
| Total Expenditures & Other Uses | 25,125,383 | 27,606,316 | 7.2% | 54,678,073 | 56,618,825 | 3.5% | 46.0% | 48.8% |

* Budgeted and actual expenditures exclude working capital, operating reserves, and capital reserves.

2008 expenditure budgets were higher than 2007 for most departments primarily due to higher personnel costs, including an unsettled labor contract from 2007 that settled in 2008. In addition to this general trend, specific highlights and budget to actual comparisons by selected departments are listed below:

- Actual 2008 expenditures for the **City Council** are **25.9 percent** ahead of the same period last year primarily due to the cost of a one-time citizen survey and changes to Council salaries and benefits.
- Actual 2008 expenditures for the **City Manager's Office** are **28.7 percent** ahead of the same period last year primarily due to the payment of NORCOM regional dispatch transition costs and also higher personnel salaries and benefit costs.
- Actual 2008 expenditures for the **City Attorney's Office** are **7 percent** ahead of the same period last year primarily due to higher legal services contract expenses from an increased number of court calendars as well as higher personnel salaries and benefit costs.
- Actual 2008 expenditures for the **Parks & Community Services Department** are **7.5 percent** ahead of the same period last year primarily due to the timing of human service agency contract payments and higher personnel costs.

Compared to 2007, 2008 General Fund actual expenditures are tracking ahead of last year primarily due to higher personnel costs, settlement of a labor contract that included back-pay for 2007 in 2008, and timing of major projects.

(Continued on page 5)

- Actual 2008 expenditures for the **Public Works Department** are **3.4 percent behind** the same period last year primarily due to a position vacancy and the completion of the one-time Verizon fiber project inspection.
- Actual 2008 expenditures for the **Planning Department** are **9.3 percent ahead** of the same time last year primarily due to the timing of payments to ARCH (A Regional Coalition for Housing), an environmental impact review for a downtown shopping center, and despite position vacancies.
- Actual 2008 expenditures for the **Police Department** are **18.9 percent ahead** of the same period last year due primarily to higher personnel costs, back payment of 2007 wages as a result of a labor contract settlement, staffing vacancies in 2007, and higher jail costs.
- Actual 2008 expenditures for the **Fire & Building Department** are **5.3 percent ahead** of the same period last year largely due to the timing of Fire dispatch contract costs. While down slightly from the same period last year, fire operations overtime costs remain a concern.

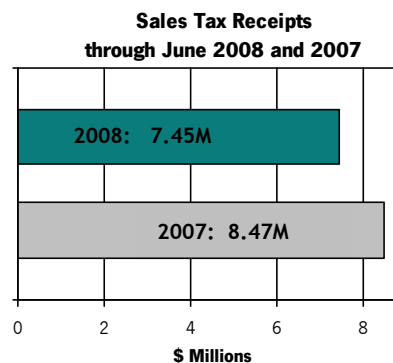


Summer Concert Series in Marina Park.

Sales Tax Revenue Analysis 2008 actual revenue is **down 12 percent** compared to the same period last year primarily due to significant softening in contracting revenue, as well as declining revenue in key retail sectors. A one-time adjustment described in the contracting sector in the next paragraph changes the decline to about 9.8 percent. (See table on page 6).

Review by business sectors:

- The **contracting** sector is **down 27.0 percent** compared to the same period last year due to the completion of major projects and a general weakening in development activity. However, significant revenue from the I-405 interchange project was received in April 2007 and later determined to be an overpayment by the Department of Revenue and subtracted from August receipts. Adjusting for the overpayment changes this sector's decline to about 16.9 percent.
- The **miscellaneous** sector is **down 39.4 percent** compared to last year primarily due to one-time revenue from an airplane leasing received last year. Factoring out identified one-time events, this sector is about 9.7 percent behind the same period last year.
- General merchandise/miscellaneous retail** is **down 7.3 percent** compared to the same period last year due to disappointing performance by key retailers—possibly a sign of weakening consumer confidence.
- The **communications** sector is **down 24.5 percent** over the same period last year due to significant development activity in this sector last year and despite moderate growth in cellular phone services this year.
- The **auto/gas retail** sector is **down 2.5 percent** compared to the same period last year. In contrast, in June 2007, this sector was up 18.0 percent compared to the previous year, which contributed almost \$250,000 in positive performance over the prior year.
- The **services** sector performance is **down 8.6 percent** compared to the same period last year due to significant one-time development activity in 2007, the departure of a major bio-tech pharmaceutical research company, and despite the strength of the accommodations subsector. It should be noted that this sector is still experiencing development-related activity, just not consistently at the same level as last year.
- Other retail** declined **4.8 percent** compared to the same period last year due to the closure of two major retailers.
- Retail eating/drinking** is **up 3.2 percent** compared to the same period last year due to relatively good results from several larger businesses as well as the collection of a past-due account from prior years.
- Another of the few bright spots, **wholesale** is **up 3.2 percent** compared to the same period last year primarily due to development-related purchases in 2008 compared to 2007.



Auto/gas retail growth helped balance declines in development revenue in 2007, but is showing negative trends during first half of 2008.

This report summarizes results through June 30, 2008. July continued the negative trend, down 12.2 percent compared to July 2007.

Bellevue first half 2008 sales tax revenue is up 5.8 percent over the same period last year primarily due to the high level of development-related activity and despite softening auto/gas retail sales.

Redmond first half 2008 sales tax revenue is down 2.3 percent.

City of Kirkland Actual Sales Tax Receipts

| Business Sector Group | January - June | | Dollar Change | Percent Change | Percent of Total | |
|------------------------|------------------|------------------|--------------------|----------------|------------------|---------------|
| | 2007 | 2008 | | | 2007 | 2008 |
| Services | 953,893 | 872,071 | (81,822) | -8.6% | 11.3% | 11.7% |
| Contracting | 1,685,810 | 1,231,413 | (454,397) | -27.0% | 19.9% | 16.5% |
| Communications | 346,991 | 261,939 | (85,052) | -24.5% | 4.1% | 3.5% |
| Auto/Gas Retail | 1,524,976 | 1,487,284 | (37,692) | -2.5% | 18.0% | 20.0% |
| Gen Merch/Misc Retail | 1,259,698 | 1,167,582 | (92,116) | -7.3% | 14.9% | 15.7% |
| Retail Eating/Drinking | 614,644 | 634,578 | 19,934 | 3.2% | 7.3% | 8.5% |
| Other Retail | 870,277 | 828,099 | (42,178) | -4.8% | 10.3% | 11.1% |
| Wholesale | 550,403 | 568,163 | 17,760 | 3.2% | 6.5% | 7.6% |
| Miscellaneous | 664,696 | 402,533 | (262,163) | -39.4% | 7.7% | 5.4% |
| Total | 8,471,388 | 7,453,662 | (1,017,726) | -12.0% | 100.0% | 100.0% |

Kirkland's sales tax base is comprised of a variety of businesses which are grouped and analyzed by business sector (according to NAICS, or "North American Industry Classification System"). Nine business sector groupings are used to compare 2007 and 2008 year-to-date sales tax receipts in the table to the left.

| Month | Sales Tax Receipts | | Dollar Change | Percent Change |
|--------------|--------------------|------------------|-------------------|----------------|
| | 2007 | 2008 | | |
| January | 1,267,021 | 1,227,855 | (39,166) | -3.1% |
| February | 1,525,665 | 1,586,493 | 60,828 | 4.0% |
| March | 1,154,890 | 1,112,704 | (42,186) | -3.7% |
| April | 1,604,395 | 1,085,739 | (518,656) | -32.3% |
| May | 1,496,755 | 1,367,777 | (128,978) | -8.6% |
| June | 1,422,662 | 1,073,094 | (349,568) | -24.6% |
| Total | 8,471,388 | 7,453,662 | -1,017,726 | -12.0% |

When analyzing monthly sales tax receipts, there are two items of special note: First, most businesses remit their sales tax collections to the Washington State Department of Revenue on a monthly basis. Small businesses only have to remit their sales tax collections either quarterly or annually, which can create anomalies when comparing the same month between two years. Second, for those businesses which remit sales tax monthly, there is a two month lag from the time that sales tax is collected to the time it is distributed to the City. For example, sales tax received by the City in June is for sales actually made in April. Monthly sales tax receipts through June 2007 and 2008 are compared in the table to the left.

- February 2008 experienced the only positive monthly increase compared to the same month in the prior year since July 2007.
- Significant revenue from the I-405 interchange project was received in April 2007 and subtracted as an overpayment in August. Normalized, the comparison for April is changed to about a 22 percent decline from the same month of the previous year.
- Adjustments between May and July receipts also skew comparisons. Normalizing for the adjustments, May is down 14.9 percent compared to May 2007 and June is down 18 percent compared to June 2007.

Kirkland's sales tax base is further broken down by business district (according to geographic area), as well as "unassigned or no district" for small businesses and businesses with no physical presence in Kirkland.

Totem Lake, which accounts for over 32 percent of the total sales tax receipts, is **down 2.3 percent** compared to the same period last year primarily due to the closure of two major retail-

ers and the departure of an pharmaceutical research company. In contrast to the city-wide trend, the auto/gas retail sector is performing well in this district. Almost 60 percent of this business district's revenue comes from the auto/gas retail and general merchandise/miscellaneous retail sectors.

NE 85th Street, which accounts for over 14 percent of the total sales tax receipts, is **down 9.8 percent** compared to the same period last year primarily due to the automotive/gas retail and general merchandise/miscellaneous retail. Over 85 percent of this business district's revenue comes from these two business sectors.

Downtown, which accounts for over 7 percent of the total sales tax receipts, is **up 2.8 percent** compared to the same period last year primarily due to moderately strong performance in the retail eating/drinking and accommodations sectors, which provide over 40 percent of this business district's

revenue and despite declines in other retail and miscellaneous sectors (manufacturing).

Carillon Point & Yarrow Bay, which accounts for almost 3 percent of the total sales tax receipts, is **down 3.8 percent** compared to same period last year primarily due to poor performance from major software companies and despite strong performance in the accommodations sector. Over 70 percent of this business district's revenue comes from business services, retail eating/drinking and hotels.

Houghton & Bridle Trails, which accounts for almost 4 percent of the total sales tax receipts, is **down 7.5 percent** compared to the same period last year almost entirely due to miscellaneous retail, which provides about 44 percent of these business districts' revenue.

Juanita, which accounts for 2 percent of the total sales tax receipts, is **up only 0.7 percent** compared to the same period last year primarily due a one-time recovery received in 2007. Factoring out the one-time 2007 receipt, this business district would be up about 9.6 percent because of the retail eating/drinking sector, which provides over 40 percent of this business district's revenue.

When reviewing sales tax receipts by business district, it's important to point out that 39 percent of the revenue received in 2008 is in the "unassigned or no district" category largely due to contracting revenue (which has declined compared to last year), and increasing revenue from Internet, catalog sales and other businesses located outside of the City.

City of Kirkland Sales Tax by Business District

| Business District | Jan - June Receipts | | Dollar Change | Percent Change | Percent of Total | |
|----------------------------|---------------------|------------------|--------------------|----------------|------------------|---------------|
| | 2007 | 2008 | | | 2007 | 2008 |
| Totem Lake | 2,472,110 | 2,415,587 | (56,523) | -2.3% | 29.2% | 32.4% |
| NE 85th St | 1,206,760 | 1,088,092 | (118,668) | -9.8% | 14.2% | 14.6% |
| Downtown | 534,894 | 549,838 | 14,944 | 2.8% | 6.3% | 7.4% |
| Carillon Pt & Yarrow Bay | 223,507 | 215,121 | (8,386) | -3.8% | 2.6% | 2.9% |
| Houghton & Bridle Trails | 296,785 | 274,431 | (22,354) | -7.5% | 3.5% | 3.7% |
| Juanita | 148,819 | 149,878 | 1,059 | 0.7% | 1.8% | 2.0% |
| Unassigned or No District: | | | | | | |
| Contracting | 1,685,916 | 1,231,545 | (454,371) | -27.0% | 19.9% | 16.5% |
| Other | 1,902,597 | 1,529,170 | (373,427) | -19.6% | 24.3% | 22.5% |
| Total | 8,471,388 | 7,453,662 | (1,017,726) | -12.0% | 100.0% | 100.0% |

Sales Tax Revenue Outlook

The volatile nature of sales tax revenue is demonstrated in current year performance. The disappointing performance in the retail sectors, especially automotive/gas retail and general merchandise/miscellaneous retail, remains a concern. The retail sectors represent the majority of the "ongoing" revenues in contrast with development activity, which is more one-time in nature. Declining retail sales tax revenue along with weakening development activity are threatening the City's ability to maintain existing services in the near future as well as deepening the budget gap for the upcoming biennium. While down from last year, development-related revenue still remains relatively strong in relation to historical trends but could drop even more dramatically if the economy continues to slow. Additional risks include the opening of Costco stores in Redmond and Bellevue by the end of 2009 and the plan for a major automobile dealership to relocate their sales activities outside the City limits. Consumers seem to be responding to higher fuel and food prices by reducing or eliminating discretionary purchases. Potential opportunities include redevelopment of major retail centers, such as Totem Lake Mall and Park Place. However, even if these projects proceed, they will not be completed for some time. As a result, the ability of these large projects to overcome the current risks is limited.

OFFICE VACANCIES:

The Eastside vacancy rate remains low at 10.1 percent and Kirkland's rate is 3.8 percent as of the second quarter of 2008 according to CB Richard Ellis Real Estate Services. There is almost 3 million square feet of office space currently under construction on the Eastside.

LODGING TAX REVENUE:

Lodging tax 2008 revenue is up 18.7 percent compared to the same period last year due to overall strong performance in the accommodations industry as well as the new hotel, which opened downtown in late 2007.

Economic Environment Update

While the region's economic growth has slowed considerably over the last few months, local economists still do not predict a recession. Local job growth continues to be strong in 2008, with almost 124,000 jobs added in the Seattle-Tacoma metropolitan area since January 2005. The unemployment rate in King County is 3.9 percent as of June 2008, well below the national and Washington State average of 5.7 and 5.4 percent respectively. Employment growth was high in 2007 at 2.8 percent; but fell to 1.6 percent so far this year and is projected to decline to 0.6 percent in 2009. The two largest employers, Boeing and Microsoft, have added over 8,000 employees between them over the last year.

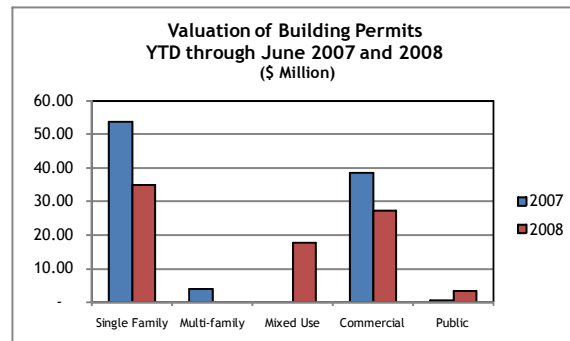
However, the Puget Sound office market saw its second consecutive quarter of negative absorption in 5 years. The Eastside office market continued its strong performance, with positive absorption. Even with two quarters of negative regional absorption, the Puget Sound region office market is expected to remain one of the strongest in the nation for some time.

Two of the local confidence indices illustrate the varying degrees of economic uncertainty. The Hebert Research Key Bank Business Confidence Index survey of local business executives slid to 43.6 for the second quarter hitting its lowest level since the last recession ended in 2003. The index is almost 7 points lower than the prior quarter and well under the historical mean of 55.9. However, indicating some optimism, the June Western Washington purchasing managers survey index climbed 4 points over the previous month to 62.6. (It should be noted that a score of more than 50 points signals an expanding economy, while a score of less than 50 points indicates a shrinking economy.)

As mentioned in the sales tax analysis, significant risks from business changes and slowing development activity could pose a financial challenge in the near future for the City.

(Continued on page 8)

Local development activity comparing 2008 to 2007 as measured by the valuation of City of Kirkland building permits is illustrated in the chart to the right. Activity has dropped considerably—especially in the single family and multi-family sectors. The only positive growth in 2008 is in the mixed-use category due to two large complexes under development. Concerns about the slowing local real estate market could have a significant impact on residential development activity in 2008.



Pending sales of new and existing single-family homes on the Eastside are down 38 percent in June 2008 compared with a year earlier and prices declined 0.8 percent for closed sales compared to the same month last year. The median price of a single family home in June was \$626,500—down from \$627,000 in June 2007. However, King County June home sales did edge up slightly over May and Western Washington's housing market continues to fare better than most metropolitan markets around the country. According to *Forbes* magazine, Seattle ranks 10th in best cities for home sellers. Four factors are widely seen as affecting whether a housing market is a good one for sellers, including job growth, amount of new construction, vacancy rates, and credit availability. Seattle ranks high due to strong job and population growth and reduced new construction activity.

Seattle metro CPI continues to track higher than the national average (6.19 percent compared to the national average of 5.6 percent as of June). The June 2008 CPI is used to calculate City employee cost of living adjustments (COLA) for 2009. As a result, the 2009 COLA for all closed bargaining units will be 6.19 percent, which is the highest adjustment in several years.

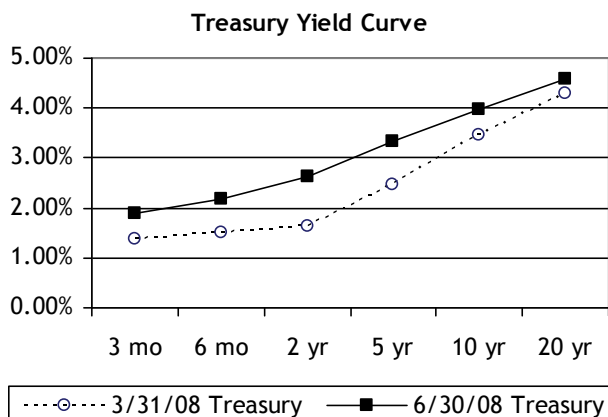
Investment Report

MARKET OVERVIEW

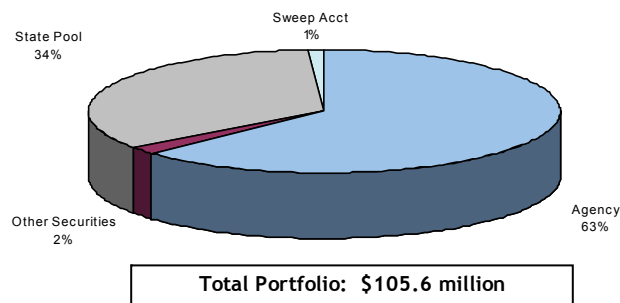
The yield curve rose in the last quarter resulting in a slightly flatter yield curve. The Fed Funds rate dropped one quarter percent to two percent during the second quarter on April 30. Peter Kretzmer of Bank of America says that the spread of the housing crisis through the financial markets has had a weakening influence on consumer and business activity in recent quarters. The economy appears to be emerging from this weakness, but oil prices, home prices, and employment are still a drag on the consumer. The surge in oil prices, commodity prices, and the dramatic increase in the consumer price index indicate that inflation is becoming a problem. Kretzmer expects that the Fed will hold the fed funds rate constant for most of this year before raising it later in the year.

quirements and conforming to all Washington state statutes governing the investment of public funds.

The primary objectives for the City of Kirkland's investment activities are: legality, safety, liquidity and yield. Additionally, the City diversifies its investments according to established maximum allowable exposure limits so that reliance on any one issuer will not place an undue financial burden on the City. The City's portfolio increased in the 2nd quarter of 2008 primarily due to property tax collections in April and May. On June 30, 2008 the total portfolio was \$105.6 million compared to \$103.7 million on March 31, 2008.



Investments by Category



CITY PORTFOLIO

It is the policy of the City of Kirkland to invest public funds in a manner which provides the highest investment return with maximum security while meeting the City's daily cash flow re-

Diversification

The City's current investment portfolio is composed of Government Agency bonds, State and Local Government bonds, the State Investment Pool and an overnight bank sweep account. City investment procedures allow for 100% of the portfolio to be invested in US Treasury or Federal Government obligations.

2008 ECONOMIC OUTLOOK and INVESTMENT STRATEGY

The forecast for the U.S. economy growth continues to be reduced. GDP growth for 2008 is now expected to be 1.7 percent down from earlier forecasts of 1.8 percent. 2009 GDP growth is expected to be 1.5 percent. Core inflation for 2008 is expected to be 2.2 percent. The unemployment rate is expected to average 5.4 percent for 2008 and 6.0 percent for 2009. This is up from earlier estimates of 5.1 percent unemployment for 2008. The Fed Funds rate is expected to remain at 2.00 percent through the end of 2008.

We will continue to watch the economy closely and move the portfolio duration to within target range as securities mature and are called. Investments will be purchased when the portfolio duration has come within the benchmark guidelines and opportunities are available to obtain a return above the State Pool and the Two Year Treasury. Total budgeted investment income for 2008 is \$4.2 million.

Subsequent Activity:

A portion of the City's portfolio is invested in the AAA rated debt of the Federal National Mortgage Association (FNMA - Fannie Mae) and the Federal Home Loan Mortgage Corporation (FHLMC - Freddie Mac). As has been seen in the news, mortgage losses recognized in July and August have caused the share prices of Fannie Mae and Freddie Mac to drop dramatically. However, it is important to note that the AAA ratings and implied guarantees of the agencies senior debt (callables, bullets, etc.) and their mortgage guarantees have not been questioned. Kirkland's investment in both of those agencies is still AAA rated and secure.

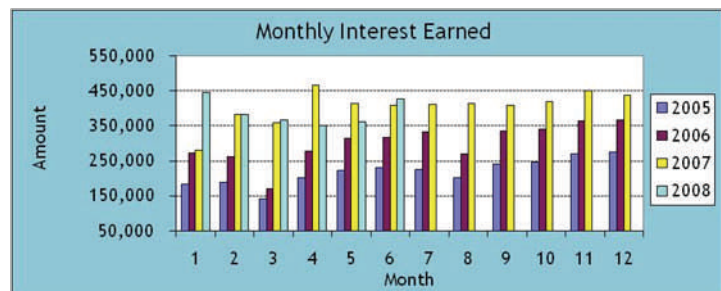
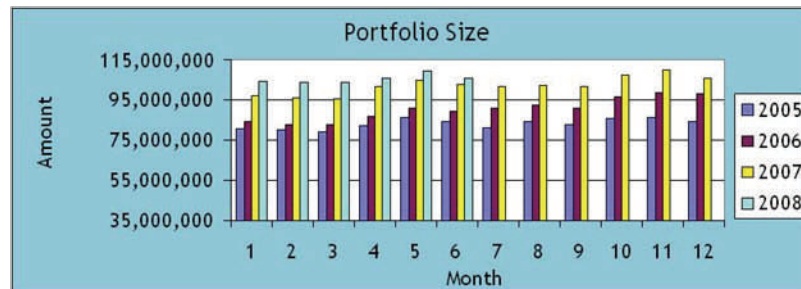
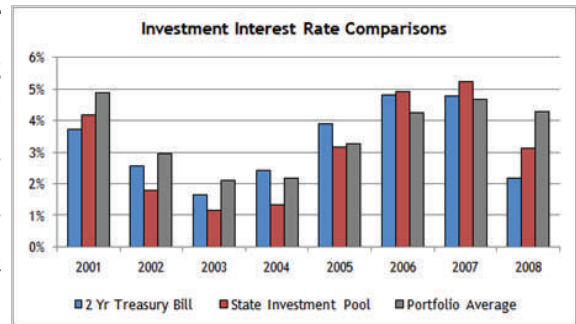
Liquidity

The target duration for the City's portfolio is based on the 2 year treasury rate which increased from 1.62 percent on March 31, 2008 to 2.63 percent on June 30, 2008. The average maturity of the City's investment portfolio increased slightly from 2.05 years on March 31, 2008 to 2.08 years on June 30, 2008. The duration is above the target due to the purchase of longer term securities to lock in higher yields. It is expected that those securities will be called on their call dates as interest rates have declined significantly since those securities were purchased.

Yield

The City Portfolio yield to maturity decreased from 4.27 percent on March 31, 2008 to 3.98 percent on June 30, 2008. Through June 30, 2008, the City's annual average yield to maturity was 4.29 percent, which exceeded the performance of the State Investment Pool whose annual average yield to maturity was 3.12 percent and above the 2 Year Treasury note annual average for 2008 at 2.17 percent. The City's practice of investing further out on the yield curve than the State Investment Pool results in earnings higher than the State Pool during declining interest rates and lower earnings than the State Pool during periods of rising interest rates. This can be seen in the adjacent graph.

| Benchmark Comparison | March 31, 2008 | June 30, 2008 |
|------------------------------|----------------|---------------|
| City Yield to Maturity (YTM) | 4.27% | 3.98% |
| City Annual Average YTM | 4.54% | 4.29% |
| City Year to Date Cash Yield | 4.48% | 4.66% |
| State Pool Average Yield | 3.76% | 3.12% |
| 2 yr Treasury Note Avg YTM | 1.81% | 2.17% |



Reserve Summary

General Operating Reserve

For the City's "Rainy Day" fund, the target is established by fiscal policy at five percent of the operating budget (excluding utility and internal service funds). Each year, the target amount will change proportional to the change in the operating budget. To maintain full funding, the increment between five percent of the previous year's budget and the current budget would be added or subtracted utilizing interest income and year-end transfers from the General Fund. It is a reserve to be used for unforeseen revenue losses and other temporary events. If the reserve is utilized by the City Council, the authorization should be accompanied by a plan for replenishing the reserve within a two to three year period.

Revenue Stabilization Reserve

The Revenue Stabilization Reserve was approved by Council in July 2003 and was created by segregating a portion of the General Operating Reserve. The purpose of this reserve is to provide an easy mechanism to tap reserves to address temporary revenue shortfalls resulting from temporary circumstances (e.g. economic cycles, weather-related fluctuations in revenue). Council set the target at ten percent of selected General Fund revenue sources which are subject to volatility (e.g. sales tax, development fees and utility taxes). The Revenue Stabilization Reserve may be used in its entirety; however, replenishing the reserve will constitute the first priority for use of year-end transfers from the General Fund.

Contingency Fund

The Contingency Fund was established pursuant to RCW 35A.33.145 to "provide monies with which to meet any municipal expense, the necessity or extent of which could not have been foreseen or reasonably evaluated at the time of adopting the annual budget." State law sets the maximum balance in the fund at \$.375 per \$1,000 of assessed valuation. This reserve would be used to address unforeseen expenditures (as opposed to revenue shortfalls addressed by the Revenue Stabilization Reserve). The fund can be replenished through interest earnings up to the maximum balance or through the year-end transfer if needed.

Reserves are an important indicator of the City's fiscal health. They effectively represent "savings accounts" that are established to meet unforeseen budgetary needs (general purpose reserves) or are otherwise dedicated to a specific purpose (special purpose reserves). The City's reserves are listed with their revised estimated balances at the end of the biennium in the table below:

| Reserves | 2007-08 Est End Balance | 2007 Auth. Uses | 2008 Auth. Uses | Revised 2007-08 End Balance |
|---------------------------------------|----------------------------|--------------------|--------------------|--------------------------------|
| GENERAL PURPOSE RESERVES | | | | |
| Contingency | 3,193,826 | 365,936 | | 2,827,890 |
| General Capital Contingency | 3,312,834 | | | 3,312,834 |
| Park & Municipal Reserve: | | | | |
| General Oper. Reserve (Rainy Day) | 2,712,836 | | | 2,712,836 |
| Revenue Stabilization Reserve | 2,082,380 | | | 2,082,380 |
| Building & Property Reserve | 1,921,002 | 10,000 | | 1,911,002 |
| Council Special Projects Reserve | 309,960 | 33,000 | 5,000 | 271,960 |
| Total General Purpose Reserves | 13,532,838 | 408,936 | 5,000 | 13,118,902 |
| SPECIAL PURPOSE RESERVES | | | | |
| Excise Tax Capital Improvement: | | | | |
| REET 1 | 6,673,678 | 796,394 | | 5,877,284 |
| REET 2 | 6,067,898 | | 35,000 | 6,032,898 |
| Equipment Rental: | | | | |
| Vehicle Reserve | 5,907,138 | | | 5,907,138 |
| Radio Reserve | 36,000 | | | 36,000 |
| Information Technology: | | | | |
| PC Replacement Reserve | 453,670 | | | 453,670 |
| Major Systems Replacement Reserve | 666,500 | | | 666,500 |
| Facilities Maintenance: | | | | |
| Operating Reserve | 550,000 | | | 550,000 |
| Facilities Sinking Fund | 1,439,951 | | | 1,439,951 |
| Impact Fees | | | | |
| Roads | 1,984,145 | | | 1,984,145 |
| Parks | 920,086 | | | 920,086 |
| Park Bond Reserve | 502,916 | | | 502,916 |
| Cemetery Improvement | 476,401 | | | 476,401 |
| Off-Street Parking | 29,564 | | | 29,564 |
| Tour Dock | 73,211 | | | 73,211 |
| Street Improvement | 1,121,498 | 161,100 | | 960,398 |
| Firefighter's Pension | 1,359,860 | | | 1,359,860 |
| Park & Municipal Reserve: | | | | |
| Litigation Reserve | 20,004 | | | 20,004 |
| Labor Relations Reserve | 51,255 | | | 51,255 |
| Police Equipment Reserve | 26,519 | | | 26,519 |
| LEOFF 1 Police Reserve | 625,754 | | | 625,754 |
| Facilities Expansion Reserve | 800,000 | | | 800,000 |
| Development Services Reserve | 1,290,831 | | | 1,290,831 |
| Tree Ordinance | 13,750 | | | 13,750 |
| Donation Accounts | 143,859 | | | 143,859 |
| Revolving Accounts | 148,606 | | | 148,606 |
| Water/Sewer Operating Reserve | 1,511,245 | | 52,106 | 1,459,139 |
| Water/Sewer Debt Service Reserve | 820,155 | | | 820,155 |
| Water/Sewer Capital Contingency | 1,703,640 | 500,200 | | 1,203,440 |
| Water/Sewer Construction Reserve | 8,738,358 | 835,000 | | 7,903,358 |
| Surface Water Operating Reserve | 320,299 | | | 320,299 |
| Surface Water Capital Contingency | 876,760 | 202,000 | 195,400 | 479,360 |
| Surface Water-Transp. Related Rsv | 1,417,365 | 236,000 | | 1,181,365 |
| Surface Water Construction Reserve | 1,240,563 | | | 1,240,563 |
| Total Special Purpose Reserves | 48,011,479 | 2,730,694 | 282,506 | 44,998,279 |
| Grand Total | 61,544,317 | 3,139,630 | 287,506 | 58,117,181 |

No Council Authorized Additions as of June 30, 2008.

Reserve Summary *continued*

USES AND ADDITIONS HIGHLIGHTS

| RESERVE | AMOUNT | DESCRIPTION |
|---|-----------|--|
| 2008 Council Authorized Uses | | |
| Council Special Projects Reserve | \$5,000 | Funding for 2008 membership dues to the Cascade Land Conservancy to become a Cascade Agenda Leadership City. |
| Water/Sewer Operating Reserve | \$39,106 | Funding for the emergency repair of a watermain leak on NE 85 th Street. |
| | \$13,000 | Funding for the Lake Washington sewer basin smoke testing. |
| Surface Water Capital Contingency | \$158,500 | Additional funding for the Juanita Creek Channel Enhancement project. |
| | \$36,900 | Additional funding for the NE 126th Street/94th Avenue NE Channel Restoration project. |
| Real Estate Excise Tax (REET) 2 Reserve | \$35,000 | Funding for the Crosswalk upgrade program - NE 120th Place near the Casa Juanita Apartments. |

2008 Council Authorized Additions

No Council Authorized Additions as of June 30, 2008.

The summary in the section above details all Council authorized uses and additions to each reserve through June 2008.

| Reserves | Revised 2007-08 End Balance | 2007-08 Target | Over (Under) Target |
|--|--------------------------------|-------------------|------------------------|
| GENERAL PURPOSE RESERVES | | | |
| Contingency | 2,827,890 | 3,698,455 | (870,565) |
| General Capital Contingency | 3,312,834 | 5,822,280 | (2,509,446) |
| Park & Municipal Reserve: | | | |
| General Oper. Reserve (Rainy Day) | 2,712,836 | 3,134,779 | (421,943) |
| Revenue Stabilization Reserve | 2,082,380 | 2,143,422 | (61,042) |
| Council Special Projects Reserve | 271,960 | 250,000 | 21,960 |
| General Purpose Reserves with Targets | 11,207,900 | 15,048,936 | (3,841,036) |
| SPECIAL PURPOSE RESERVES | | | |
| Excise Tax Capital Improvement: | | | |
| REET 1 | 5,877,284 | 1,435,000 | 4,442,284 |
| REET 2 | 6,032,898 | 4,959,200 | 1,073,698 |
| Information Technology: | | | |
| Major Systems Replacement Reserve | 666,500 | 1,025,000 | (358,500) |
| Firefighter's Pension | 1,359,860 | 1,103,000 | 256,860 |
| Park & Municipal Reserve: | | | |
| Litigation Reserve | 20,004 | 50,000 | (29,996) |
| LEOFF 1 Police Reserve | 625,754 | 855,000 | (229,246) |
| Development Services Reserve | 1,290,831 | 1,290,831 | 0 |
| Water/Sewer Operating Reserve | 1,459,139 | 1,511,245 | (52,106) |
| Water/Sewer Debt Service Reserve | 820,155 | 820,155 | 0 |
| Water/Sewer Capital Contingency | 1,203,440 | 1,703,640 | (500,200) |
| Surface Water Operating Reserve | 320,299 | 320,299 | 0 |
| Surface Water Capital Contingency | 479,360 | 876,760 | (397,400) |
| Special Purpose Reserves with Targets | 20,155,524 | 15,950,130 | 4,205,394 |
| Reserves without Targets | 26,753,757 | n/a | n/a |
| Total Reserves | 58,117,181 | n/a | n/a |

The table to the left compares the revised ending balance to the targets established in the budget process .



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- ◆ Sri Krishnan, Senior Financial Analyst
- ◆ Neil Kruse, Budget Analyst

www.ci.kirkland.wa.us

The Financial Management Report (FMR) is a high-level status report on the City's financial condition that is produced quarterly.

- It provides a **summary budget to actual comparison** for year-to-date revenues and expenditures for all operating funds. The report also compares this year's actual revenue and expenditure performance to the prior year.
- The **Sales Tax Revenue Analysis** report takes a closer look at the City's largest and most economically sensitive revenue source.
- **Economic environment** information provides a brief outlook at the key economic indicators for the East-side and Kirkland such as office vacancies, residential housing prices/sales, development activity, inflation and unemployment.
- The **Investment Summary** report includes a brief market overview, a snapshot of the City's investment portfolio, and the City's year-to-date investment performance.
- The **Reserve Summary** report highlights the uses of and additions to the City's reserves in the current year as well as the projected ending reserve balance relative to each reserve's target amount.

Economic Environment Update References:

- Jeanne Lang Jones, *Puget Sound executives' optimism ebbs amid nation's economic woes*, Puget Sound Business Journal, August 1, 2008
- *Washington purchasing index climbs a bit in June*, Puget Sound Business Journal, July 7, 2008
- Elizabeth Rhodes, *King County home sales edge up in June.....*, The Seattle Times, July 8, 2008
- CB Richard Ellis Real Estate Services, *Market View Puget Sound*, Second Quarter 2008
- Northwest Multiple Listing Service
- Washington State Employment Security Department
- Washington State Department of Revenue
- Washington State Department of Labor & Industries
- U.S. Bureau of Labor Statistics
- City of Kirkland Building Division
- City of Kirkland Finance Department